LIBRARY
SUPREME COURT. U. S.

Office-Supreme Court, U.S.
FILED
DEC 31
JAMES R. BROWNING, Clerk

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1958

Nos. 237 and 290

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., and SECURITIES AND EXCHANGE COMMISSION, *Petitioners,*

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA, and THE EQUITY ANNUITY LIFE INSURANCE COMPANY, *Respondents.*

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

## BRIEF FOR THE EQUITY ANNUITY LIFE INSURANCE COMPANY, RESPONDENT

BENJAMIN H. DORSEY
SMITH W. BROOKHART
RALPH E. BECKER
1700 K. Street, N. W.
Washington, D. C.

## INDEX


| | Page |
|---|---|
| Opinion Below | 1 |
| Jurisdiction | 2 |
| Question Presented | 2 |
| Statement of the Case | 2 |
| Summary of Argument | 15 |
| Argument | 17 |
| I. Under the Securities Act an Annuity Is Not Within the Definition of "Security". § 3(a)(8) of the Act Furthermore Specially Exempts "Any . . . Annuity" From the Definition of a "Security". In Enacting the Securities Act It Was the Intention of Congress That "Insurance" and "Annuity" be Determined by Appropriate State Officials | 17 |
| A. Under the Securities Act an annuity is not within the definition of a "Security" | 17 |
| B. To make misinterpretation impossible, Congress provided the specific exemption for insurance and annuity policies | 22 |
| II. The Purpose of the Exemption in the Investment Company Act for Insurance Companies Was to Make Certain That Insurance Companies Would Not be Regulated by SEC | 29 |
| III. The McCarran Act Precludes Federal Securities Legislation From Being Superimposed Upon the District of Columbia Life Insurance Act and Making Illegal the Corporate Structure and Policies of Respondents. Congress Has Barred SEC From Regulating the Business of Insurance | 38 |
| Conclusion | 43 |

## CITATIONS


CASES: Page

American Hospital & Life Insurance Co. FTC, 243 F. (2d) 719, aff'd 357 U.S. 560 ..... 28
Atalanta Trading Corp. v. FTC, 258 F (2d) 365 .... 27
Equitable Life Assurance Society v. Brown, 213 U.S. 25 ..... 15
Haberman v. Equitable Life Assurance Society, 224 F. (2d) 401, modified, 225 F. (2d) 837, cert. den. 350 U.S. 948 ..... 18
Haynes v. U.S., 353 U.S. 81 .....23, 25
Helvering v. LeGierse, 312 U.S. 531 ..... 9
In re Union Guarantee & Mortgage Co., 75 F. (2d) 984, cert. den. 296 U.S. 594 ..... 26
Prudential Insurance Company v. Benjamin, 328 U.S. 408 ..... 39
SEC v. Ralston Purina Co., 346 U.S. 119 .....27, 28
Spellacy v. American Life Insurance Ass'n, 144 Conn. 346, 131 A. (2d) 834 ..... 40
Wilburn Boat Co. v. Fireman's Fund Insurance Co., 348 U.S. 310 ..... 42

STATUTES:

District of Columbia Life Insurance Act, District of Columbia Code, Title 35, Chapters 3-8 ...2, 3, 4, 5, 12, 16, 30, 33, 34, 35, 36, 37, 38
Investment Company Act of 1940, 15 U.S.C. 80a-1 et seq. ..2, 3, 11, 16, 17, 29, 30, 32, 33, 37, 38, 40, 41
McCarran Ferguson Insurance Regulation Act, 15 U.S.C. 1011-1015 .....17, 38, 40, 41
Securities Act of 1933, 15 U.S.C. 77a et seq. .....2, 3, 12, 15, 16, 17, 18, 19, 20, 21, 22, 23, 25, 26, 27, 28, 29, 40, 41

MISCELLANEOUS:

Federal Bar News, V. 5 No. 10, October 1958 .....25-26
Federal Income Tax Regulations, § 1.72-2(b)(3) .. 25
Hearings before Subcommittee of the Committee on Banking and Currency on S. 3580, 76th Cong. (1940) ..... 31
Hearings before Subcommittee of Committee on Interstate and Foreign Commerce on H.R. 10065, 76th Cong., (1940) .....31, 32

Page

H. Doc. No. 707, 75th Cong. ..... 30
H. Rept. 85, 73rd Cong., (1933) .....18, 22-23
H. Rept. No. 2639, 76th Cong., (1940) ..... 31
Krueger & Waggoner, The Life Insurance Policy Contract .....9, 15
Life Insurance Fact Book, 1954 ..... 14
Life Insurance Fact Book, 1956 ..... 22
Loss, Securities Regulation .....18, 19, 30
McCormick, Understanding The Securities Act and the SEC .....18, 19, 23
Mehr & Osler, Modern Life Insurance ..... 6
Public Law 85-699, 85th Cong., 72 Stat. 689 ..... 25
Report on Investment Trusts and Investment Companies, Part I ..... 30
S. Rept. 1200, 85th Cong. ..... 40
S. Rept. No. 1775, 76th Cong., (1940) ..... 31
S. Res. 231, 85th Cong. ..... 40
41 Col. L. R. 269 .....32, 33
32 Notre Dame Lawyer 643 ..... 6

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1958

---

Nos. 237 and 290

---

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., and SECURITIES AND EXCHANGE COMMISSION, *Petitioners,*

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA, and THE EQUITY ANNUITY LIFE INSURANCE COMPANY, *Respondents.*

---

**On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit**

---

## BRIEF FOR RESPONDENT THE EQUITY ANNUITY LIFE INSURANCE COMPANY

---

### OPINIONS BELOW

The opinion of the Court of Appeals is reported at 257 F. (2d) 201, (R. 885-891). The opinion of the District Court (R. 82-94) is reported at 155 F. Supp. 521.

## JURISDICTION

The jurisdiction of this Court has been invoked under 28 U.S.C. § 1254(1).

## QUESTION PRESENTED

Did the Court of Appeals properly interpret the statutes herein involved and the legislative intent underlying them in holding that, there is "an unmistakable determination on the part of Congress to leave the insurance business in the control of the states until Congress should in plain terms exert its power over some or all aspects of it . . ." and "the definitions in the Securities Act and the Investment Company Act indicate that if the insurance commissioner of the state subjects the business to his supervision, it is the business of insurance"?

## STATUTES INVOLVED

The statutes involved are set forth in Appendix A to the brief of the Securities and Exchange Commission with the exception of the District of Columbia Life Insurance Act of 1934, Title 35, Chapters 3-8 of the District of Columbia Code (1951 Ed.). It is not practicable to set out such an extensive Act in this brief.

## STATEMENT OF THE CASE

As stated by Petitioner, National Association of Securities Dealers, Inc. (hereinafter "NASD"), individual variable annuity contracts were first written in the United States in 1952. (NASD Br., p. 5). Group variable annuity contracts were written by the major life insurance companies prior to that time. (R. 539).

Individual variable annuity contracts were first written by the College Retirement Equities Fund (CREF), chartered by the New York legislature as a companion corporation to Teachers Insurance & Annuities Association, a legal reserve life insurance company (TIAA). (R. 482-484). Since TIAA's experience had shown fixed-dollar annuities to be unsatisfactory in providing annuities for college and university teachers, it was decided to organize CREF which would invest completely in equities, but which would guarantee payments, not in terms of dollars but in terms of units. (R. 480-485). In order to avoid the investment limitations of New York law pertaining to insurance companies, CREF was created by a special Act of the legislature with supervision of the Company in the Superintendent of Insurance. (R. 484, 491). At the end of 1956, CREF variable annuities covered 31,156 individuals (D. Ex. 36, R. 847) and its net assets were $39,817,151.

CREF makes no guarantees whatsoever. It is "the best example of a pure insurance arrangement that you could have". Whatever occurs with regard to investment experience, mortality, or expenses is reflected in the payments to annuitants. (R. 485). No attempt has ever been made to require CREF to register its variable annuity policies as securities under the Securities Act or to classify it as an investment company under the Investment Company Act of 1940.

Respondents were organized and operate solely as life insurance companies under the provisions of the District of Columbia Life Insurance Act of 1934.

They are subject to the supervision of the Superintendent of Insurance of the District of Columbia and the Insurance Commissioners of other states in which they are licensed to do business. (F.F. 3-23; R. 94-99). The only business which the respondents are permitted to conduct "shall be restricted to the business of insurance appertaining to persons." Title 35, § 501(d), D. C. Code. (F.F. 4; R. 95). Respondents operate on a general agency basis. Every general agent and every agent selling respondents' policies must be licensed by the Insurance Department in either the District of Columbia or the state in which the company operates. (F.F. 25; R. 99). All of the details of respondents' organizations have been approved by the Superintendent of Insurance and the Corporation Counsel of the District of Columbia. (F.F. 5-15, R. 95-98). All of respondents' policies have been approved by the Superintendent of Insurance of the District of Columbia as required by § 35-708 of the D. C. Code, and by all states in which the companies are licensed. (F.F. 31, R. 101; F.F. 23, R. 99; R. 506). These policies and their general terms and provisions are described in Findings of Fact 31-35, R. 101-105. Such policies contain the standard provisions required for annuities as set forth in § 35-705, D. C. Code. The legal investments for respondents' funds, as for any other life insurance company chartered in the District of Columbia, are set forth in § 35-535 of the D. C. Code. (F.F. 39, R. 106). Respondents' Articles of Incorporation, approved by the Corporation Counsel of the District of Columbia, permit them "To grant, purchase or dispose of life insurance and variable annuity policies stated in terms of units, the value of which is based

in whole or in part on equity type of investments permitted by Section 535 of said 'Life Insurance Act' of the District of Columbia, as amended, and as the same may hereafter be amended." (F.F. 4, R. 95; F.F. 18, R. 98).

Respondents issue a number of variable annuities in addition to the individual deferred annuity policies on which petitioners rest their case. (SEC Br., pp. 3-4; NASD Br., p. 5). All types of respondents' variable annuity policies have the same "pertinent characteristics" as SEC asserts. Br. pp. 3-4. One example of such other policies may be illustrative.

In 1957 this respondent issued a $30,000 single premium immediate variable annuity policy to one Grenville Clark, aged 74. Such policy guaranteed: (1) Annual payments for the life of the annuitant. (2) The first payment to be due February 1, 1958. (3) The dollar amount of each such payment will be measured by the value on payment date of 3827.50 annuity units. (4) The mathematical formula for adjusting the value of the annuity unit in accordance with investment experience. The dollar amount of the annuity payments determined in accordance with the provisions of the contract will vary with the investment experience of the company but cannot be reduced by company expenses (other than certain taxes) or by the company's adverse mortality experience, if different from that of the Progressive Annuity Mortality Table. (D. Ex. 102; R. 877-880).

The Grenville Clark annuity, like all other of respondents' contracts, has characteristics unknown in a "security": (1) his rights terminate on death, his estate receiving no payment thereafter; and his

right to a determinable annual amount, established by his sex and age, continues as long as he lives, regardless of how long this may be. Petitioners' security experts knew of no security having such characteristics. (R. 305-306, 394). (2) Clark's risk of outliving his capital is shifted to the company, which guarantees the mortality assumptions and, subject to such guarantee, distributes the risk among the group of annuitants; i.e., reserves released by early deaths become available for payment to those having extended longevity. (R. 458-459).

Respondent agrees with SEC that a security holder's "risk is identical to that of all others who purchase the same security." Br. pp. 33-34. Conversely, an annuitant's risk is inextricably personal to him since its benefits are dependent upon the continuation of his life.

An annuity is a contract between a policyholder and a life insurance company which must provide for the payment of an income to a specified person, which income continues for, and only for, the lifetime of that person, the amounts of the payments being determined in such manner as to expend both principal and interest over the lifetime of the annuitant. Such annuity payments must be determined by actuarial methods involving the use of a mortality table. (R. 457, 478). A variable annuity is an annuity. (F.F. 30, R. 100; R. 281-282, R. 415, 467-468, 486, 489). Mehr & Osler, *Modern Life Insurance,* 1956 Ed., pp. 82-86; 32 Notre Dame Lawyer 643 (1957).

The distinction between a fixed-dollar annuity and a variable annuity is found solely in the presence or absence of expressed and particular dollar guarantees

of the benefits to be conferred. (R. 469-471). Actuarily both the fixed-dollar annuity and the variable annuity are calculated by identical principles. (R. 467, 471, 486-487, 489, 526-527). A fixed-dollar annuity accumulates and guarantees cash values during the pay in period. (R. 526-527). A variable annuity guarantees a formula for accumulating and determining cash values during the pay in period. (R. 526-527). A fixed-dollar annuity pays out in terms of fixed monetary units, i.e., dollars. (R. 459). A variable annuity pays out in terms of a contractually fixed formula which may yield varying dollars. (R. 459, 470; F.F. 30, F.F. 28, R. 100-101). Both the fixed-dollar and respondents' variable annuity assume the risk of mortality from the moment a contract is issued. (R. 461, 494, 538, 562).

A mortality table is an actuarial prognostication that a certain number of annuitants will survive to specified ages. (R. 217-219, 461). Since each annuity payment is in part a return of capital as well as, in part, a reflection of investment experience, the mortality guarantee is of great benefit. (R. 254, 458, 461). If a substantial number of annuitants live beyond their predicted demise, the company issuing the contract, be it a fixed-dollar contract or a variable annuity contract, must nevertheless continue to make annuity payments on the basis of the mortality prediction guaranteed by the contract. (R. 281-282, 296, 461). This is the mortality risk assumed by respondents and other insurers from the moment a policy is written. (R. 282, 296, 461, 494).

The trend over the years has been for increased life expectancy. Consequently, mortality tables used to-

day may be inadequate to compensate the insurer for the risk assumed. (R. 250, 463-465, 562, 564-565). This has occurred in the past with the result that companies had to strengthen their reserves from surplus in the light of increasing life expectancy. (R. 251-252, 464-465).

If respondents have underestimated mortality, a portion of annuity payments must be provided from assets otherwise belonging to stockholders. (R. 282, 461, 562, 564). As petitioners' expert witness confirmed, the fact that respondents are stock companies rather than mutual companies, affords greater protection to policyholders. (R. 299).

The distinction between the fixed-dollar annuity and the variable annuity is blurred when individual participating annuities are considered. A participating policyholder in the accumulation period may leave his dividends with the company; since dividends are never guaranteed, the total cash value in the fixed-dollar annuity contract, which is used to provide the annuity benefit upon retirement, may be unknown until retirement. In the pay out period dividends paid may increase annuity payments. Unfavorable investment experience would weaken a company's surplus and, in a mutual company, cause policyholders to participate in the loss as was the case with the Pacific Mutual Insurance Company. Participating annuities have not been classed as "securities" by petitioners. (F.F. 28, R. 100; R. 222-225, 297, 452-453, 470-471, 473, 527).

Petitioners in their treatment of risk shifting have confused the fundamental distinction between "insur-

able risk" and "investment risk" in the law of insurance. (SEC Br., pp. 8, 13, 17, 35; NASD Br., pp. 17, 19, 23, 24). The insurable risk is one which, on impact, creates a loss unique to the individual policyholder, leaving other policyholders unaffected. Such a risk can be shifted to the life insurance company and by it distributed over the whole group. (R. 456, 890-891).

Investment risks are not insurable risks because they do not satisfy two essential requirements within the definition of insurable risk; namely, that the loss must be predictable by some actuarial method and that the losses to be sustained can be shared by those who are exposed to that loss. (R. 460-461). The assumption of an investment risk by an insurance company is not an indispensable element or function of insurance. (R. 459, 472). Such fact was recognized by this Court in *Helvering* v. *LeGierse,* 312 U.S. 531. The assumption of an investment risk by an insurance company is only a "by product" of quoting premiums on a level basis, i.e., premiums payable remain constant despite changes in the policyholder's age. In the initial years of the policy the premium paid is larger than necessary to compensate the insurance company for the mortality risk assumed. A conservative portion of the investment earnings to be derived from the premium becomes the guaranteed cash value of the policy. (R. 459-460, 535). Krueger and Waggoner, *The Life Insurance Policy Contract* (1953 Ed.), 194, 251; cited, 357 U.S. 58. Such guaranteed cash values often are set at a level so that investment risk is almost entirely eliminated. (R. 472-473). Insurance policies written on a natural premium basis, where a change

of age causes a change in premium, guarantee no cash value, i.e., one year term insurance. (R. 262-263).

As the Court of Appeals held (R. 890), the insurable risk assumed by respondents is the mortality risk. (R. 220, 255, 461, 494, 538).

It is undisputed that there are millions of dollars of group insurance in force today in which the insurance companies have assumed no portion of the investment risk. The Immediate Participation Guaranteed Policy (IPG) sold by major life insurance companies including Metropolitan, Equitable, John Hancock, Prudential and Connecticut General guarantees no interest assumption; the investment risk is borne entirely and directly by the policyholder. The fund is credited or debited annually in accordance with the actual net interest rate earned by the insurance company, charged annually with actual expenses, charged with variations in experience from assumed mortality and adjusted annually for capital gains and losses (R. 539, 553-554, 561). Petitioners have never contended that these contracts are securities or that insurance companies issuing them were investment companies.

Only a life insurance company can offer a variable annuity. Spreading distribution of a capital amount and the earnings therefrom over a lifetime in accordance with scientific tables of mortality is the exclusive province of life insurance. (R. 441-442, 494). Petitioner's expert witnesses from the securities field confirm this fact. (R. 305-306, 322, 346, 392-396). If the variable annuity cannot be issued by the life insurance industry it cannot be issued by any institution.

Petitioners demonstrate a misunderstanding of the essential distinction between insurance and any other economic activity in their assertion that insurance policies *may* be written by investment companies. (SEC Br., p. 61; NASD Br., p. 37, fn. 2) They refer to the activities of United Funds, Inc., a mutual fund, to support the proposition that an investment company can be an insurance company. (SEC Br., p. 31). No evidence has been adduced to support the proposition that an investment company could write life insurance. The evidence is that United Funds, Inc., does not engage, nor wish the public to believe that it engages, in the life insurance business. United Funds, through a group creditor policy issued to it by the John Hancock Life Insurance Company, enables participants in its Periodic Investment Plan to obtain decreasing term life insurance from a life insurance company. United Funds, Inc., is not, of course, regulated by any state Department of Insurance. (R. 347-357).

Similarly, SEC misstates the case in asserting that there is an investment company which has an arrangement with an insurance company whereby shares of the investment trust are converted into an annuity based on a mortality table guaranteed by the insurance company at the time of buying into the mutual fund. SEC further asserts that "these companies" are registered with SEC under the Investment Company Act. (Br., p. 32). The companies referred to, Advisers Fund, Inc., and Standard Life Insurance Company, have provided in their arrangement that Standard Life "reserves the right to withdraw the offer or modify the rates or other terms of the commitment . . .". (R. 450-451, 808). Standard Life is not regis-

tered with SEC as an "investment company" nor are its annuities registered with SEC under the Securities Act.

**Mechanics of Calculation of Variable Annuity Benefits**

A life insurance company issuing a deferred variable annuity or a deferred fixed-dollar annuity exchanges its contractual promises for the premium paid by the policyholder. The premiums are the property of the insurance company. A policyholder is under no obligation to continue to pay premiums. (R. 124, 221, 296 469, 544, 554). After deducting from the premiums amounts specified in the policy, the net premiums become part of the total investable assets of the company. The investable assets must be invested only as authorized by Congress for all District of Columbia life insurance companies. Title 35, § 535, D.C. Code. (F.F. 39, R. 106). Investable assets include capital and surplus as well as net premiums, there being no segregated funds. (R. 296, 550).

In a fixed-dollar annuity net premiums are accumulated and adjusted by a nominal assumed investment rate. (R. 497). In a variable annuity net premiums are accumulated and adjusted by actual investment experience. (R. 527). The parallel between the cash value accumulations on fixed-dollar and variable annuities is shown by D. Ex. 41, R. 853.

Accumulated cash value could be reported annually to variable annuity policyholders on a dollar and cents basis as the books of the company are kept. However, reporting only a dollar cash value would not enable the policyholder to ascertain what portion of the cash value would be attributable to investment earnings and what portion would be attributable to his new

premiums. Accordingly, it was decided to report cash values to policy holders in terms of accumulation units—the number of which represents net premiums applied—and the dollar value of which represents the index of the company's investment experience. (F.F. 36, R. 105; R. 527).

At the commencement of the pay out period the accumulated cash value of either a fixed-dollar or a variable annuity is used to provide the annuity benefit selected by the annuitant; if he wishes he may withdraw his accumulated cash value. (R. 221, 498). His death prior to the pay out period results in such cash value being paid to his beneficiary. (R. 235) In either type annuity, in insurance terminology the annuitant is exercising an option and his accumulated cash value is converted to purchase the benefit. (R. 123, 254, 487). Using the accumulated cash value and the mortality table guaranteed in the policy, the annuity benefit is determined and the annuitant is paid that amount for the first month. If respondents' investment experience thereafter is always precisely 3½%, all subsequent payments will be the same. To the precise extent that such investment experience varies from 3½%, the subsequent annuity payments will vary. (F.F. 37, R. 105; R. 181-182, 487, 528).

As in the accumulation period, the company uses a reporting device, the annuity unit, the value of which informs the policyholder of the variations in the company's actual investment earnings from the assumed investment rate of 3½%. (R. 528).

The use of symbolic "units" has long been common in the life insurance business. (R. 534-537). For statistical purposes group annuities usually are re-

ported "on the basis of paid-up units set up to date, with additional units of retirement income to be added each year." 1954 Life Insurance Fact Book, p. 30. Typical fixed-dollar annuities provide for ". . . units of stipulated payment" (D. Ex. 42, R. 854) and "premium-units" (D. Ex. 43, R. 855).

Accumulation and annuity units have neither actuarial nor accounting function in the operation of the annuity business conducted by respondents. (R. 524-537). They are statistical devices designed and used for the purpose of keeping the policyholder informed as to the cash surrender value of his policy and the investment experience of the company. (F.F. 36, R. 105; F.F. 37, R. 105). Beyond this usage they add nothing to an understanding of the insurance principles on which the variable annuity is based.

The prinicpal Findings of Fact on which SEC relies, appear to be Nos. 46, 47 and 70 (R. 107, 109), Br., pp. 5, 6. In submitting proposed Findings of Fact to the District Court, petitioners did not attempt to demonstrate where evidence could be found to justify such Proposed Findings. (R. 31-47). These Findings are erroneous and predicated upon the alleged existence of a "reserve fund" in which each policyholder has an "aliquot" interest, and led the District Court into the mistaken belief that respondents had "created a reserve fund for investment mainly in common stocks." (R. 90). Insurance companies, including respondents, are required by law to maintain policy reserves. The policy reserve in life insurance is a technical expression meaning the amount of money which the company must have, together with premiums and assumed investment income, in order to meet

obligations as they are actuarily calculated to mature. Such reserve is a liability. (R. 488). Krueger and Waggoner, *supra*, p. 251. SEC's theory would result in the absurdity of policyholders having interests in a liability. These Findings were disregarded by the Court of Appeals.

As this Court has held, a policy of life insurance creates the legal relationship of debtor and creditor between an insurance company and a policyholder. No trust relation results from an insurance policy. This legal relationship has been delineated in *Equitable Life Assurance Society* v. *Brown*, 213 U.S. 25, 46 (1908):

> They lay no foundation for the jurisdiction of a court of equity in such a case, unless it appears that the relation between the policy holder and the defendant is that the latter is the trustee of the former by reason of the trust relation between them resulting from the insurance policy. The complainant's contention, as above stated, that there is such a trust in the fund mentioned, has never been regarded as the law in the state of New York . . . , nor anywhere else so far has any case has been cited on the subject. * * * It has been held that the holder of a policy of insurance, even in a mutual company, was in no sense a partner of the corporation which issued the policy, and that the relation between the policy holder and the company was one of contract, measured by the terms of the policy.

## SUMMARY OF ARGUMENT

1. Under the Securities Act insurance and annuities are not within the definition of a "security". The purpose of § 3(a)(8) of the Securities Act, specifically exempting "Any . . . annuity contract" from the definition of a "security" was to make misinterpretation

of this fact impossible. The tests of exemption under § 3(a)(8)—that the contract be an annuity as determined by applicable state law and that the corporation issuing it be subject to the supervision of the insurance commissioner—cannot be disputed. The major purpose of Congress in enacting the Securities Act was to supervise through disclosure the theretofore largely unregulated securities field and not to superimpose the requirements of that Act on the fully regulated field of insurance.

2. Under § 3(c)(3) of the Investment Company Act "Any . . . insurance company" is exempt from the Act. The definition of "insurance company" in that Act, § 2(a)(17), requires that the company be organized as an insurance company, that its primary and predominant business be the writing of insurance, and that the company be subject to the jurisdiction of the insurance commissioner of a state. It cannot be disputed that respondents are organized and approved to do business solely as insurance companies, that their business is restricted by the D. C. Code and their charters to the business of life insurance and variable annuities, and that they are subject to the supervision of the Superintendent of Insurance. The purpose of Congress in enacting the Investment Company Act was to regulate the theretofore largely unregulated mutual fund industry where effective state regulation was difficult if not impossible. The purpose of Congress in enacting this statute was not to make illegal the corporate structure and policy provisions of legally approved life insurance companies and their policies.

3. Under the District of Columbia Code all aspects of respondents insurance activities and insurance policies have been found to be in conformity with law.

Regulation of respondents under §§ 18(a)(1)(A) or 18(f) of the Investment Company Act would make illegal their present corporate structures and annuity policies. Such statutory construction would impair, supersede and invalidate the state law enacted for the purpose of regulating the business of insurance. Except for the statutes enumerated in the proviso of § 2(b) and § 4 of the McCarran Act, Congress intended that no other federal statute should be construed as authorizing federal regulation of the business of insurance unless such federal statute affirmatively provides for such regulation.

## ARGUMENT

### I

**Under the Securities Act an Annuity Is Not Within the Definition of "Security". § 3(a)(8) of the Act Furthermore Specifically Exempts "Any . . . Annuity" From the Definition of a "Security". In Enacting the Securities Act It Was the Intention of Congress That "Insurance" and "Annuity" be Determined by Appropriate State Officials.**

#### A. UNDER THE SECURITIES ACT AN ANNUITY IS NOT WITHIN THE DEFINITION OF A "SECURITY".

In enacting the Securities Act Congress undertook to regulate the interstate sales of securities through the disclosure requirements of the Securities Act. Theretofore the interstate sale of securities had not been regulated on the federal level. Congress then knew of the history, extent and meaning of insurance and annuity policies in the United States as well as the effectiveness of state regulation of insurance. With the understanding of these facts, Congress carefully drafted the statute believing, "The entire tenor of the act would lead, . . ., to the exclusion of insurance policies from the provisions of the

act . . .". H. Rept. 85, 73rd Cong. (1933). Eminent commentators in the field of federal securities regulation concur in this view. McCormick, *Understanding The Securities Act and the SEC,* p. 79; Loss, *Securities Regulation,* p. 322, states that "it is hardly conveivable that Congress would have subjected insurance policies to fedreal control *sub silentio,* even where the control was merely of the disclosure variety."

A case in support of this proposition is *Haberman* v. *Equitable Life Assurance Society,* 224 F. (2d) 401, modified, 225 F. (2d) 837, cert. den., 350 U.S. 948. In that case, the Court considered the Texas Securities Act which does not contain a specific exemption for insurance and annuity policies from the definition of "security". The Texas definition of "security" is modeled after the definition of "security" in § 2 of the federal Securities Act. The Court concluded that the legislative history of the federal Securities Act made it obvious that an annuity was not a "security". In discussing the nature of an annuity the Court said, at pp. 405-406:

> * * * *Certainly annuities issued by regulated insurance companies are not at all similar to the securities specifically enumerated in the statute. In fact, we would not regard "investment contract" as a correct description of an annuity.* While annuities are sometimes called investments, that is not an apt characterization. Indeed, it is not unusual to hear a person say he is investing in a new suit or a new car, but the essence of such transaction is really quite different. *An annuity* is also quite *different*; what makes it essentially an annuity is *that it is a form of risk-sharing.* In life insurance, the risk from which protection is usually sought is that the insured may die young without provision for his dependents; in

an annuity, the risk is that the annuitant may live long, outliving his means for his own support. *To the extent that insurance or annuities are risk-sharing, they are certainly not investments. It is true that investment or other objectives can be combined in such plans, but they are not of their essence. Besides, we perceive a striking difference between the instruments specifically included in the definition, on the one hand, and insurance and annuity policies of regulated companies, on the other*; the latter are governed by a special statutory scheme, and reserves are required by law to be maintained for them. Thus we think the general words "investment contract" cannot be reasonably interpreted as including something so dissimilar to the specifically named instruments, as the annuity in this case. Whether they might include an annuity issued by one not a regulated insurance company, we need not decide.

As for the words, "any other instrument commonly known as a security," we do not recall a single instance in which we have heard an annuity called a security either by the learned or the vulgar. (Emphasis supplied)

However, the specific exemption for insurance and annuity policies contained in § 3(a)(8) of the Securities Act, in the words of Loss, "creates a negative implication that insurance policies *are* securities, which may be exempt from the registration requirements but are subject to the anti-fraud provisions. Nevertheless, the Commission has taken the position that insurance or endowment policies or annuity contracts issued by regularly constituted insurance compaines were not intended to be securities, and that in effect Section 3(a)(8) is supererogation." Id., pp. 322-323. As McCormick states, "only those insurance or annuity policies are exempt which are issued by

corporations under the jurisdiction of a designated insurance supervisor of a State, Territory, or the District of Columbia." Id., pp. 79-80.

Respondent concurs in the conclusions of the Court of Appeals (R. 891), the commentators, and the long settled position of the SEC, previous to this litigation, that the Securities Act did not intend to include insurance and annuity policies within the definition of "security", and that Congress did not intend SEC to inquire into the particular mechanics of any insurance or annuity policy issued by an insurance company subject to the supervision of a designated insurance supervisor.

The authority to dissect an insurance or annuity policy which SEC argues for, would, as here, create anomalies. For example, SEC here separates the deferred variable annuity into two portions, for purposes of establishing jurisdiction, and concedes that perhaps the reach of the Securities Act does not extend to the pay out period of the variable annuity. (Br., p. 43). SEC's plea for jurisdiction over the accumulation period would have no effect on respondents' immediate annuities, since they are in the pay out period immediately upon issuance, even though the immediate annuity has the same "pertinent characteristics" as the deferred annuity. (SEC Br. p. 3). Nevertheless, respondents would be classed by SEC as investment companies when a deferred variable annuity was written but would be classed as insurance companies when an immediate variable annuity was written.

If the essential legal principle involved in this case is the right of SEC to regulate annuity contracts

wherein the investment risk is borne by the policyholder, then there is no logical distinction between SEC regulation during the pay in period and SEC regulation in the pay out period. Who bears the investment risk inherent in the variable annuity is not relevant in deciding whether a state was correct in determining that a particular policy is insurance and may be issued by an insurance company.

Respondents' variable annuities are not the only variable annuities wherein the investment risk is borne by the policyholder. Under the CREF variable annuity covering more than 31,000 lives, and the IPG annuity, sold by major insurance companies in the United States, no portion of the investment risk is borne by the insurance company. SEC has not sought to regulate those policies as securities or the companies as investment companies.

The conclusion must follow from the facts that the bearing of the investment risk by an annuity policyholder is not a proper test upon which to predicate SEC regulatory authority over annuity policies and life insurance companies.

The determination of what constitutes "insurance" or "annuity" was left by Congress to the various state legislatures and appropriate state insurance regulatory officials as is shown by the legislative history of the Securities Act.

**B. TO MAKE MISINTERPRETATION IMPOSSIBLE, CONGRESS PROVIDED THE SPECIFIC EXEMPTION FOR INSURANCE AND ANNUITY POLICIES**

§ 3(a)(8) of the Securities Act exempts from the definition of "security", as set forth in § 2 of the Act,

> (8) *Any* insurance or endowment policy or *annuity contract* or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia. (Emphasis supplied).

It was known by Congress in 1933 that the various states had their own insurance statutes and regulatory bodies. It was also well known that the insurance industry had not been offering a static and unchanging product to the public. More than half of all life insurance in force today represents uses of insurance protection which have either been introduced or received their major development in the past 25 years. Life Insurance Fact Book, 1956. There is no evidence that Congress wanted to freeze the insurance industry into the then existing patterns of policies and coverage. The evidence is that Congress did not intend SEC to have any regulatory jurisdiction over insurance policies and companies, regardless of changes that might occur.

The House Report, accompanying the bill that became the Securities Act expresses the Congressional intent; that § 3(a)(8) was inserted in the bill to make clear

> ". . . what is already implied in the act, namely, that *insurance policies are not to be re-*

> *garded as securities* subject to the provisions of the act. The insurance policy and like contracts are not regarded in the commercial world as securities offered to the public for investment purposes. The entire tenor of the act would lead, even without this specific exemption, to the exclusion of insurance policies from the provisions of the act, *but the specific exemption is included to make misinterpretation impossible.* (Emphasis supplied). H. Rept. No. 85, 73rd Cong. 15 (1933).

Although there is no precise indication of legislative intent regarding the meaning of "Any", the first word in § 3(a)(8), it would appear that "Any" was intended to embrace without restriction all policies past or future "issued by corporations under the jurisdiction of a designated insurance supervisor of a State, Territory, or the District of Columbia." *McCormick, supra,* pp. 79-80.

Beyond these requirements Congress did not undertake to otherwise define "Any . . . annuity". Obviously the matter of who bore the investment risk in a particular policy was not used to delineate types of annuities. As in *Haynes* v. *U. S.,* 353 U.S. 81 (1957), Congress intended the exemptive insurance language to have a broad general meaning. As this Court there said:

> "The crucial question is whether the Southern Bell plan should be treated as 'health insurance' within the meaning of § 22 (b)(5). Broadly speaking, health insurance is an undertaking by one person for reasons satisfactory to him to indemnify another for losses caused by illness. We believe that the Southern Bell disability plan comes within the meaning of health insurance.

If Southern Bell had purchased from a commercial insurance company health insurance that provided its employees with precisely the same kind of protection promised under its own plan, the Government concedes that the payments received by ailing employees from the commercial company would not have been taxable. Nevertheless it argues that Southern Bell's plan should not be treated as 'health insurance' because the employees paid no fixed periodic premiums, there was no definite fund created to assure payment of the disability benefits, and the amount and duration of the benefits varied with the length of service. We do not believe that these facts remove the plan from the general category of health insurance. The payment of premiums in a fixed amount at regular intervals is not a necessary element of insurance. Similarly there is no necessity for a definite fund set aside to meet the insurer's obligations. And the fact that the amount and duration of benefits increased with the length of time that an employee worked for Southern Bell reflected the added value to the company of extra years of experience and service. Apparently the Government relies on these facts primarily to show that Southern Bell's plan did not contain features which would be present in the normal commercial insurance contract. The Government, however, offers no persuasive reason why the term 'health insurance' in § 22(b)(5) should be limited to the particular forms of insurance conventionally made available by commercial companies. Certainly there is nothing in the language of § 22(b)(5) which compels this limitation.

There is no support in the legislative history for the Government's argument that Congress intended to restrict the exemption provided in § 22 (b)(5) to 'conventional modes of insurance' and not to include employer disability plans. For

reasons deemed satisfactory, Congress, since 1918, has chosen not to tax receipts from health and accident insurance contracts. The language of § 22(b)(5) appeared in the Revenue Act of 1918 and has reappeared without relevant change in all succeeding revenue acts up to 1954. The term 'health insurance' was not defined in any of these acts or in any of the committee reports. There has been no uniform administrative practice which can be drawn upon to support the narrow meaning of § 22(b)(5) now urged by the Government. Administrative rulings since 1918 appear to have regularly vacillated between holding receipts under company disability plans taxable and holding that they are not taxable. Under these circumstances we see no reason why the term 'health insurance' in § 22(b)(5) should not be given its broad general meaning." pp. 83-85.

In contrast to its attitude toward health insurance in *Haynes,* the Internal Revenue Service has determined that benefits under a variable annuity contract are taxable as amounts received as an annuity. § 1.72-2(b)(3), Federal Income Tax Regulations.

Since 1933 Congress has many times amended the Securities Act but § 3(a)(8) has remained unchanged. § 3 of the Securities Act was amended as recently as August 21, 1958, P.L. 85—699, 85th Cong., 72 Stat. 689. Although variable annuities have been in existence since at least 1952, Congress has not extended the jurisdiction of the SEC to variable annuities. The attitude of the Chairman of the House Committee having jurisdiction over federal securities regulation, House Interstate and Foreign Commerce Committee, has been made public:

"The concept of an agency of limited powers granted by law appears to be a difficult one to

> comprehend, and it is frequently replaced by the notion that the agency is empowered to control anything which the practicalities of the situation as the agency views them appear to warrant. Put differently, the notion seems to be with some thinking that as an industry grows or as new technologies are developed the agency's powers expand or change accordingly. I am thinking of the power of the Federal Communications Commission to authorize and regulate subscription television; the power of the Federal Trade Commission to regulate advertising by insurance companies; and the power of the Securities and Exchange Commission to regulate variable annuities under life insurance policies." *Federal Bar News,* V. 5, No. 10, October, 1958, p. 298.

SEC takes the position that "§ 3(a)(8) was not specifically designed to encompass 'variable annuities' since there were no variable annuities in 1933 when the Act was adopted." Br. p. 39. Respondent agrees that Congress did not specifically draft § 3(a)(8) to encompass the variable annuity. Congress designed § 3(a)(8) to exempt "Any" annuity issued by a life insurance company under the jurisdiction of an insurance supervisor. As is the case in the Bankruptcy Act, Congress has delegated to the states the power to define "insurance" and "annuity" and "subjects that meaning to change as those [state] laws change". *In re Union Guarantee & Mortgage Co.,* 75 F. (2d) 984, 985, cert. den., 296 U.S. 594. It is submitted that "Any" in the context of the statute applies to all annuity policies past, present and future where such annuity is issued by an insurance company under the jurisdiction of an insurance supervisor unless and until, as the Court of Appeals held, "Congress should in plain terms exert its power over some or all aspects of it [insurance business]." (R. 891).

SEC asserts that the differences between the variable annuity and annuities issued in 1933 eliminates the reason for the statutory exemption. Br. p. 39. SEC is, of course, entitled to its opinion regarding § 3(a)(8) and the reasons underlying the fact that it has never been amended by Congress but, it is submitted that such opinion cannot excise the Subsection or extend the reach of the statute. As the District Court held, "Congress only can make such contracts and companies amenable to the regulations of SEC." (R. 94). "The expertise possessed by an administrative agency, however, does not empower it to rewrite the laws which it has been charged with enforcing. This is the function of Congress." *Atalanta Trading Corp.* v. *FTC,* 258 F. (2d) 365, 374 (1958).

*SEC* v. *Ralston Purina Co.,* 346 U.S. 119 (1953), is the principal legal authority relied upon by SEC to establish its argument that

> The need of a purchaser of a variable annuity for information with which to assess his investment risk is important not only in determining whether the variable annuity is a security but also in determining whether it is exempt from registration. SEC Br. p. 38.

In the *Ralston* case stock of the company was regularly offered to certain of its employees. There was no question but that this stock was a "security". The issue in the case was whether or not the company's stock offerings to its employees involved a "public offering" as that term is used in § 4(1) of the Securities Act. § 4 of the Act deals with exempt transactions; § 3 of the Act, herein involved, deals with exempt securities. The scope of the 4(1) private offering

exemption is not spelled out in the Securities Act. However, the purpose of the exemption was to exempt transactions where there is no "practical need" for the offerees to have the information which registration would disclose. Accordingly, this Court held that there is an affirmative burden on the claimant for a private offering exemption to show that the offerees do not need such information.

In contrast, § 3 of the Securities Act deals with "classes of securities" which are exempt from the Act. In § 3(a)(8) Congress has by clear implication resolved the matter of which agency shall protect the public interest by making the tests of exemption solely dependent upon state action. Congress seems to be satisfied that state regulation of insurance protects the public interest. As it has been said ". . . . the business of insurance has been more generally regulated than any other sphere of business activity not a public utility." *American Hospital & Life Insurance Co.* v. *FTC,* 243 F. (2d) 719, 721, aff'd 357 U.S. 560.

SEC cites *Ralston* for the proposition that the specific tests for the insurance exemption in § 3(a)(8) should be determined by "the need of the offerees for the protections afforded by registration." (Br. p. 33). This argument is so completely lacking in support in the language of the statute, its legislative history or any judicial precedent that SEC has resorted to a fallacious analogy between the holding of *Ralston,* regarding § 4(1), and the exemption set forth in § 3(a)(8). *Ralston* stands for the proposition that the claimant for the private offering exemption has the affirmative burden of proving that the offerees do not need to know the information contained in a

registration statement, whereas § 3(a)(8) stands for the proposition that if the claimant for exemption establishes that it is deemed an annuity under state law and that the company issuing it is supervised by state insurance officials, the tests for exemption have been met.

That Congress did not intend SEC to oversee the actions of state legislatures and regulatory agencies seems clear from the fact "Section 3(a)(8), 15 U.S.C. 77c(a)(8), provides *a total country-wide exemption* where the insurance is issued by a company licensed by *any* state authority." (SEC Br., p. 56, fn. 40).

## II

### THE PURPOSE OF THE EXEMPTION IN THE INVESTMENT COMPANY ACT FOR INSURANCE COMPANIES WAS TO MAKE CERTAIN THAT INSURANCE COMPANIES WOULD NOT BE REGULATED BY SEC

§ 3(c)(3) of the Investment Company Act exempts from the reach of that Act "Any bank or insurance company;". § 2(a)(17) defines "insurance company":

> 'Insurance company' means a company which is organized as an insurance company, whose primary and predominant business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies, and which is subject to supervision by the insurance commissioner or a similar official or agency of a State; or any receiver or similar official or any liquidating agent for such a company, in his capacity as such.

There can be no question but that respondents (1) are organized as insurance companies (F.F. 3-18, R. 94-98) (2) not only are primarily and predominantly engaged in the life insurance business but are restricted by law to "the business of insurance ap-

pertaining to persons." Title 35, § 501(d), D.C. Code. (F.F. 4, 18, R. 95, 98) (3) are subject to the supervision of one or more insurance commissioners. (F.F. 3-21, R. 94-99) The requirements of the exemption are definite and specific. It is likewise definite and specific that respondents meet all such requirements.

SEC disregards the tests of the statute and the evidence and argues that these exemptive tests "must be construed in the light of the 'dominating general purpose' of the Act." (Br. p. 49) As contrasted with the nebulous "dominating general purpose" of the Act, Loss in his book "Securities Regulation" sets forth, quoting the 10th Annual Report of the SEC, five main purposes of the Act. First: Regulation of selling practices of investment companies. Second: Honest and unbiased management. Third: Greater participation in management by security holders. Fourth: Adequate and feasible capital structures. Fifth: Financial statements and accounting. Loss, *supra,* pp. 99-101.

The legislative history of the Investment Company Act sheds further light on the purpose of the Act.

In 1935 Congress authorized SEC to make a thorough study of the abuses in "investment companies." Public Utility Holding Company Act, § 30. In 1938-40 SEC published its comprehensive *Report on Investment Trusts and Investment Companies.* This Report (Part I, H. Doc. No. 707, 75th Cong., p. 33, fn. 30) reflected that the SEC, specifically directed to study "investment companies," had excluded insurance companies selling annuity contracts or life annuities from the survey because they "were deemed to be without the purview of the study, and therefore not included in the survey."

The SEC recommendations were embodied in S. 3580, introduced March 1940. In extensive public hearings, spokesmen for the securities industry criticized the proposed bill. After conferences between investment trust representatives and SEC, compromise measures were substituted which satisfied SEC and the industry. *Hearings before Subcommittee of Committee on Interstate and Foreign Commerce on H. R. 10065,* 76th Cong. (1940); *S. Rept. No. 1775,* 76th Cong. (1940); *H. Rept. No. 2639,* 76th Cong. (1940). The House and the Senate passed the bills unanimously, with little discussion.

Nothing in this history hints that Congress intended to superimpose federal on state insurance regulation. The following exchange, in August, 1940, between Senator Wagner, sponsor of the bill, and Senator Byrnes, is significant:

> "Mr. Byrnes: Mr. President, the bill has nothing to do with the regulation of insurance companies?
>
> "Mr. Wagner: Of course not." 86 *Cong. Rec.* 10071.

David Schenker, Chief Counsel for SEC, testified:

> "There we go on to say any bank or insurance company is exempt, and we have to make that specific exemption because fire-insurance companies invest and reinvest in securities, as do also insurance companies and banks."
>
> *Hearings before Subcommittee of the Committee on Banking and Currency on S. 3580, 76th Cong.,* pp. 176-177 (1940).

Fire insurance companies, where the amount of the benefit payable is necessarily variable and unknown

until after the loss, have for a long period been permitted by law to invest, and have invested a substantial portion of their assets, in stock and equity type securities.

In June, 1940 Mr. Schenker again stated:

> "Now, we have, in order to be meticulously careful, specifically excluded some types of companies from the purview of this bill . . . Paragraph 3 excludes banks, insurance companies, and savings and loan associations."
>
> *Hearings on H.R. 10065, supra,* p. 102.

As far as insurance companies are concerned with the Investment Company Act, the dominating purpose of the Act was to exclude them from the scope of the Act. The reason for this exclusion, apart from the basic differences between insurance companies and investment companies, was the fact that insurance companies were already subject to adequate governmental supervision while, as the Act states, § 1(a)(5), effective state regulation of investment companies was difficult if not impossible.

As stated in an informed comment:

> It is illuminating to notice that while investment companies bear a close resemblance to savings banks and insurance companies (indeed, some of the earliest investment companies developed as offshoots to insurance companies), yet legislative curbs comparable to the plethora of regulations which surrounds banks and insurance companies have never been imposed upon investment companies, likewise organizations which like . . . insurance companies . . . are already subject to adequate governmental supervision . . . are not deemed investment companies within the meaning of the Act.

The Investment Company Act of 1940, 41 Col. L. R. 269, 274, 277 (1941).

SEC argues that the Investment Company Act should be construed to embrace respondents because "Purchasers of respondents' variable annuities have no protection comparable to those afforded by the Investment Company Act." (Br. 29) This rash statement indicates SEC's complete lack of any understanding of the business of insurance.

Insurance regulation commences prior to the formation of a company and encompasses every activity of the insurance company on its merits. (F.F. 26, R. 99). In the District of Columbia the Insurance Superintendent is vested with "supervision of all matter pertaining to insurance, insurance companies, . . . subject only to the general supervision of the Commissioners" (L.I.A. § 35-101). His office is public, and records, books and papers on file are public records (L.I.A. § 35-401).

Organization: Proposed articles of incorporation, together with $10,000 bond, are filed with the Superintendent, and newspaper notice is published (L.I.A. § 35-502). The Corporation Counsel examines the proposed articles and, if he so finds, certifies them to be in accordance with law (L.I.A. § 35-503). The Company must deposit securities of not less than $100,000 to protect policyholders (L.I.A. § 35-415, § 35-416). The Superintendent may examine any person under oath, and all books and records, pending organization (L.I.A. § 35-506). He must be satisfied as to the company's qualifications before he authorizes it to act (L.I.A. § 35-404). The Superintendent's certificate of authority to the insurance company (L.I.A. § 35-503)

is on an annual basis (F.F. 6, 8, 9, R. 96), revocable for impropriety (L.I.A. § 35-405). If the Superintendent "finds that public interest would be best served by the continued operation of the company" he may, in lieu of revoking a certificate of authority for causes enumerated, subject such company to a penalty. (L.I.A. § 35-405).

Policies: All life insurance and annuity contracts must be approved by the Superintendent (L.I.A. § 35-705, § 35-708). They must include standard provisions life, L.I.A. § 35-703; annuities, L.I.A. § 35-705). Other provisions are prohibited (L.I.A. § 35-704). All applications, riders, and endorsements relating to annuities must be approved (L.I.A. § 35-705).

Home office operation: The company must keep its principal office and its records in the District (L.I.A. § 35-204). All investments must be in media approved by the Life Insurance Act as lawful for insurance companies (L.I.A. § 35-535).

Sales activities: Respondents, like other life insurance companies, operate through the general agency system. (F.F. 25, R. 99). Each general and soliciting agent must be licensed by the insurance authority of his State/District. (ibid). The applicant for an agent's or broker's license must supply full details, some specified in the law, "and such other information as the Superintendent may require" (L.I.A. § 35-425, § 35-428). An applicant for a broker's license may be subjected to examination (L.I.A. § 35-428). When the Superintendant is satisfied of the qualifications and trustworthiness of the applicant, he issues a license on an annual basis (L.I.A. § 35-425, § 35-428).

Disclosure of basic financial data: Respondents report annually to the Superintendent on the standard form (L.I.A. § 35-406, 407; § 47-1802), recommended by the National Association of Insurance Commissioners. (R. 653). This report, 42 pages each 12" x 19", is "designed to ferret out every fact which the [NAIC] Committees, over the years, have deemed significant," and is on file and available for inspection by any interested party in any state where respondents operate. (R. 268).

Annually the Superintendent examines and certifies the valuation of respondents' policy reserves (L.I.A. § 35-701(a); R. 812). The statute vests in the Superintendent discretion with respect to reserves for life insurance policies providing a varying amount of insurance or varying premiums, for annuities, and for other forms of coverage (L.I.A. § 35-701(c) (2) (b)).

The company, every person having knowledge of it, and all its books and records, are subject at all times to examination (L.I.A. § 35-418). The subpoena power (L.I.A. § 35-412) is supplemented by an immunity statute (L.I.A. § 35-802) which effectively eliminates privilege against self incrimination. The examiner's report to the Superintendent may be published in a newspaper (L.I.A. § 35-418).

Respondents are also subject at intervals to detailed "convention" examinations by a corps of examiners representing states in which they do business. (R. 512).

Sanctions against false or misleading statements. The Life Insurance Act blankets this field:

The company is subject to revocation of authority to do business, its agent to cancellation of license, if any officer, director, general agent, solicitor, broker, or other person falsely represents the terms or benefits of a policy, "or the dividends or shares of surplus to be received thereon", or other facts concerning the company's operation (L.I.A. § 35-714).

Advertising standards are set, and violation is a misdemeanor (L.I.A. § 35-409, § 35-410). Directors are personally liable for any of eight types of misconduct, including false notices or deceiving the public (L.I.A. § 35-526). A director, officer, agent or employee wilfully making any false statement in any statement required by law is subject to imprisonment for 2-10 years (L.I.A. § 35-408). The license of a general agent, agent, or solicitor may be suspended or revoked for any of eight reasons, including misrepresentation or a finding that he is "untrustworthy" (L.I.A. § 35-426).

Protection against impairment of capital: The Superintendent may suspend the authority of any life insurance company to operate when he considers further transaction of business hazardous to policyholders, creditors, or "the public" (L.I.A. § 35-405). After notice and hearing, he may revoke the authority to do business for any of 11 reasons, including insolvency, impairment of capital or surplus, failure to comply with the law, misrepresenting the "terms of any policy", or has "used any name or title of any policy . . . misrepresenting the true nature thereof" (L.I.A. § 35-405). He may apply to the District Court for a show cause order to take possession of the company's property and conduct its business for any of six reasons, ranging from insolvency, to a finding that

further business will be hazardous to policyholders, to a general finding of "activities against public policy" (L.I.A. § 35-419).

It is submitted that the insurance regulation to which respondents are amenable provides far greater protection to policyholders than any statute administered by SEC. It is also submitted that the unsupported and unrealistic SEC assertion that "the possibilities of abuse inherent in the sales of their contracts" (Br. p. 33) should confer jurisdiction upon SEC is without foundation in fact, as well as in law.

*The practical thrust of the plea of SEC for jurisdiction over respondents under the Investment Company Act would be to make illegal the variable annuity policies issued by them in conformity with District of Columbia law.* § 18(f) of the Investment Company Act, applicable if respondents were classed as an open-end investment company, prohibits the investment company from having any form of senior security. Since respondents' variable annuity policies are claims of creditors against the company they are senior to the rights of stockholders; consequently policies could not be issued. § 18(a)(1)(A) of the Investment Company Act, applicable if respondents were classed as a closed-end investment company, prohibits the issuance of a senior claim unless it has an asset coverage of 300%. No insurance company could operate on such a basis. Insurance reserves are calculated to insure coverage of an anticipated amount of loss and are always only a percentage of insurance-in-force figures. Insurance companies operate on the principle of receiving relatively small premiums from a large group to meet individually unexpected or irregular losses.

SEC now admits for the first time that "respondents would have to alter their structure and the provisions of their present contracts to comply with some of the Act's provisions." Br. p. 54. This admission demonstrates the inherent clash between the differing requirements of the regulatory systems established for the insurance field and for the securities field. It is unthinkable that Congress intended such a clash when it enacted the Investment Company Act. The specific exemption in that Act for insurance companies was obviously intended to prevent the possibility of such a fundamental clash.

As the government recently asserted in Nos. 435 and 436, October Term, 1957, Br. p. 25, where in the field of insurance regulation "there is an obvious collision between federal and state policy . . . Congress has decreed that state policy should be controlling."

## III

**The McCarran Act Precludes Federal Securities Legislation From Being Superimposed Upon the District of Columbia Life Insurance Act and Making Illegal the Corporate Structure and Policies of Respondents. Congress Has Barred SEC From Regulating the Business of Insurance.**

As above set forth, a construction of the federal securities Acts holding respondents subject to the jurisdiction of the SEC would make illegal their corporate structures and policies specifically approved by the Superintendent of Insurance and Corporation Counsel of the District of Columbia under the Life Insurance Act of the District of Columbia. As SEC states, "respondents would have to alter their structure and the provisions of their present contracts to comply with some of the Act's provisions" Br. 54. Such

superimposition of federal securities legislation on existing state insurance regulatory authority flies in the face of the McCarran Act. As this Court said in *Prudential Insurance Company* v. *Benjamin*, 328 U.S. 408 (1946)

> Obviously Congress' purpose was broadly to give support to the *existing and future* state systems for regulating and taxing the business of insurance. This was done in two ways. One was by removing obstructions which might be thought to flow from its own power, whether dormant or exercised, except as otherwise expressly provided in the Act itself or in future legislation. The other was by declaring expressly and affirmatively that continued state regulation and taxation of this business is in the public interest and that the business and all who engage in it 'shall be subject to' the laws of the several states in these respects.
>
> Moreover, in taking this action Congress must have had full knowledge of the nation-wide existence of state systems of regulation and taxation; of the fact that they differ greatly in the scope and character of the regulations imposed and of the taxes exacted; and of the further fact that many, if not all, include features which, to some extent, have not been applied generally to other interstate business. Congress could not have been unacquainted with these facts and its purpose was evidently to throw the whole weight of its power behind the state systems, notwithstanding these variations.
>
> * * * * *
>
> But, though Congress had no purpose to validate unconstitutional provisions of state laws, except in so far as the Constitution itself gives Congress the power to do this by removing obstacles to state action arising from its own action or by consenting to such laws, H. Rep. No. 143, 79th

Cong., 1st Sess., p. 3, *it clearly put the full weight of its power behind existing and future state legislation to sustain it from any attack under the commerce clause* to whatever extent this may be done with the force of that power behind it, *subject only to the exceptions expressly provided for.*

Two conclusions, corollary in character and important for this case, must be drawn from Congress' action and the circumstances in which it was taken. One is that Congress intended to declare, and in effect declared, that *uniformity of regulation, and of state taxation, are not required in reference to the business of insurance, by the national public interest, except in the specific respects otherwise expressly provided for.* pp. 429-430, 430-431. (Emphasis supplied).

SEC professes concern over lack of uniformity occasioned by varying state insurance statutes and interpretations by insurance regulatory officials and courts. Br. p. 47. SEC cites *Spellacy* v. *American Life Insurance Ass'n*, 144 Conn. 346, 131 A. (2d) 834, for the proposition that the states have already differed regarding whether or not their insurance laws authorize variable annuities. Respondent does not challenge the right of the Connecticut Insurance Commissioner, Mr. Spellacy, to interpret and seek enforcement of Connecticut insurance statutes. The action was *not* an attempt to enforce a securities statute and is illustrative of the variations in state insurance laws and the effectiveness of state regulation. The effectiveness of state regulation permitted by the McCarran Act continues to be scrutinized by Congress without apparent dissatisfaction. S. Res. 231, S. Rept. 1200, 85th Congress.

SEC takes the further position that even if it was held that the Securities Act and the Investment Com-

pany Act invalidate, impair or supersede state laws dealing with insurance, "still Section 2 of the McCarran Act (15 U.S.C. 1012) saves them since they 'specifically relate to the business of insurance.'" Br. 60. SEC argues for this construction on the basis of the references to insurance in the Securities Act and the Investment Company Act which references, according to SEC, gave Congressional expression to the extent to which there might be SEC regulation of insurance. Such references to insurance clearly exempt respondents' insurance and annuity policies from the definition of "security" in the Securities Act and clearly include respondents within the definition of "insurance company", exempt from the Investment Company Act. The Congressional intent is clear—reference to insurance in these Acts is solely for the purpose of exempting it from SEC regulation.

SEC also takes the position that Congress intended dual regulation of insurance companies and their policies and that the McCarran Act intended to leave this system untouched. Br. 61. The portions of statutes cited for this conclusion do not sustain it. Congress has never intended or permitted federal securities statutes to regulate insurance.

As the District Court held

> When, however, the Congress passed the McCarran Act and set at naught the decision of the Supreme Court in the case of United States v. South-Eastern Underwriters Association, et al., 322 U.S. 533 (1944), it excluded all Federal agencies from regulatory jurisdiction over all insurance companies and insurance business except such agencies as it then excepted or might in the future except. SEC has not been made an exception.

> In view of the fact that the defendants have been chartered as insurance companies by the District of Columbia and their questioned contracts have been approved by the Insurance Superintendent of the District, and by the insurance departments of certain states, this Court is constrained to hold that the broad, explicit and impelling language of the McCarran Act makes them exempt from Federal regulation unless and until Congress provides otherwise.
>
> The arguments which plaintiffs advance here should be made to the Congress. (R. 90-91).

In affirming this decision the Court of Appeals held

> The statutes which we have quoted above show an unmistakable determination on the part of Congress to leave the insurance business in the control of the States until Congress should in plain terms exert its power over some or all aspects of it. The appellants say that, by definition, the business of the appellees is not insurance. We find no such definition. The definitions in the Securities Act and the Investment Company Act indicate that if the insurance commissioner of a state subjects the business to his supervision, it is the business of insurance. (R. 891).

As this Court held in *Wilburn Boat Co.* v. *Fireman's Fund Insurance Co.*, 348 U.S. 310, 319, 320-321 (1955):

> In the *South-Eastern* case, however, all the opinions had emphasized the historical fact that States had always been free to regulate insurance. The measure Congress passed shortly thereafter, known as the McCarran Act, was designed to assure that existing state power to regulate insurance would continue. Accordingly, the Act contains a broad declaration of congressional policy that the continued regulation of insurance by the States is in the public interest, and that silence on

the part of Congress should not be construed to impose any barrier to continued regulation of insurance by the States.

The hearings on the McCarran Act reveal the complexities and difficulties of an attempt to unify insurance law on a nationwide basis, even by Congress. Courts would find such a task far more difficult. Congress in passing laws is not limited to the narrow factual situation of a particular controversy as courts are in deciding lawsuits. And Congress could replace the presently functioning state regulations of marine insurance by one comprehensive Act. Courts, however, could only do it piecemeal, on a case-by-case basis. Such a creeping approach would result in leaving marine insurance largely unregulated for years to come.

* * * * *

Under our present system of diverse state regulations, which is as old as the Union, the insurance business has become one of the great enterprises of the Nation.

Congress has been exceedingly cautious about disturbing this system, even as to marine insurance where congressional power is undoubted. We, like Congress, leave the regulation of marine insurance where it has been—with the States.

## CONCLUSION

For the foregoing reasons the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

BENJAMIN H. DORSEY
SMITH W. BROOKHART
RALPH E. BECKER
1700 K. Street, N. W.
Washington, D. C.